TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

April 29, 1980

## Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

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Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Transcript of Federal Open Market Committee Conference Call of April 29, 1980

CHAIRMAN VOLCKER. Good morning, gentlemen. We only met a week ago but the markets have moved and the money supply has moved. Perhaps we better have Mr. Axilrod tell us how they have moved.

MR. AXILROD. Mr. Chairman, following the Committee meeting we had a very sharp drop in the money supply numbers that were coming in. The data we published for M-1A for the week ending [April] 16th turned out to be $1.4 billion lower than the preliminary estimate we had at the time of the Committee meeting. Also for M-1A the number that came in for the 23rd turned out to be $5.7 billion lower than we had been projecting for that week; [our estimate reflected the number needed] in order to have a decrease in the money supply for April of only 4 percent. Given the data we have in hand through the 23rd--with the 23rd being a preliminary estimate and assuming some increase but a modest increase for the 30th--our estimate for M-1A growth in April is now minus 12 percent. Our estimate for M-1B growth for April is minus 9 percent and our estimate for M2 is plus 0.2 percent.

This weakness in both demand deposits and currency has weakened required reserves and therefore [reduced] the amount of total reserves that we would expect in this four-week intermeeting period. Given these required reserve figures for the first two weeks of the four-week period and our projection for the last half of the four-week period, our total reserves appear to be running about $400 million below path, largely reflecting this decrease in required reserves. And of course, in providing the nonborrowed reserves, we would be expecting borrowing to be dropping substantially. Our estimate is that instead of the $1-1/2 billion of borrowing ex First Pennsylvania that had been indicated at the time of the Committee meeting for the weeks of April 30th and May 7th, we'd be looking at borrowing of something like $910 million and declining to something like $660 million in the next two weeks.

Of course this week, the week ending April 30th, borrowing thus far is running higher than that $900 million--somewhere on the order of $1.5 billion ex First Pennsylvania, as banks did borrow substantially earlier in the week. Given these reserve paths and the projected levels of implied borrowing, it would seem that the federal funds rate would begin dropping below the 15 to 16 percent notional range mentioned at the Committee meeting. Most recently, yesterday and thus far today, it has been in the 14 to 15 percent area.

CHAIRMAN VOLCKER. Would you like to add anything, Mr. Sternlight?

MR. STERNLIGHT. I wouldn't have anything to add [on the aggregates and reserves]. I'll just add the thought that as we were aiming for the nonborrowed reserves on the path, [we have seen] along with those weakening aggregates a further decline in rates, especially short rates. The bill rates in yesterday's auction, for example, were down nearly 2 percentage points for the 3-month bill and about 1 percentage point for the 6-month bill.

CHAIRMAN VOLCKER. How would you characterize market gossip and attitudes?

SEVERAL. We can't hear.

MR. MORRIS. We couldn't hear Peter's response to your first question, Paul.

CHAIRMAN VOLCKER. Well, he can repeat that and answer my further question.

MR. STERNLIGHT. I commented first to Chairman Volcker that I didn't have anything to add to Steve's commentary on the aggregates. But with respect to interest rate moves in the past week, I noted that at the short end there had been a further marked decline--particularly in bill rates. In yesterday's auction, rates were down from a week earlier by close to 2 percentage points for the 3-month bill and around 1 percentage point for the 6-month bill.

The Chairman then asked me about market attitudes. I think there has been some surprise in the markets at the extent of the rate declines. I do not get a strong sense at this point, I must say, of great concern in the markets about the extent of the declines. Nevertheless, my own inner feeling is that such a concern could build up if we were to continue to get sizable declines and if there were a market sense that we were permitting, with little or no resistance, substantial further declines in rates. But I would honestly have to say that up to now I do not sense great alarm, from the domestic markets anyway, about the extent of the decline in rates.

CHAIRMAN VOLCKER. Do you have anything to add from the perspective of the foreign markets, Mr. Pardee?

MR. PARDEE. All I can say is that since the FOMC meeting, the dollar has declined by about 3-3/4 percent against the German mark and has declined against other currencies pretty much across the board. Again that largely [reflects] the decline [in U.S. rates] in relation to the climb of [foreign] interest rates, which has been particularly precipitous in the Eurodollar market. We also had the effort to release the hostages, which when it occurred did lead to some selling of dollars. At the moment it occurred the Bundesbank went quickly to the market and intervened. We have not intervened in big amounts. We've done about $150 million worth of marks and some Swiss francs. The Bundesbank has done about We have not been in a mode of trying to resist very heavily the movement of the dollar, given that the market perception is that the problem is not intervention but a decline in interest rates.

CHAIRMAN VOLCKER. I'm tempted to ask why they consider that a problem.

MR. PARDEE. As I outlined at the FOMC meeting, it's a matter of timing in that interest rates have come down before there was any indication that we were making progress on inflation or on the trade balance. The market currently is waiting for the trade figures this afternoon.

CHAIRMAN VOLCKER. Where is the dollar/mark now?

MR. PARDEE. It's 179.5. It was 186 at the time of the FOMC meeting.

CHAIRMAN VOLCKER. The only thing I have to add by way of any information is that I think it's very likely that we will get an increase in the German discount rates this week--not necessarily presented as a great tightening of money, but there it is.

As Mr. Axilrod described, we have a situation where, because the money supply and therefore the reserve need is even less than we thought at the time of the Federal Open Market Committee meeting, the federal funds rate has already in the last day and a half moved below the range that we talked about as a checkpoint. I suppose one could argue, if one were in that mood, that it has already gone further than it should, on a timing basis anyway. We could leave it alone around this area but say that we would be disturbed about further immediate declines. Or at the other extreme we could say that we would not be disturbed about further declines. We do have an official checkpoint. It is the boundary limit in the present directive. We don't have to do anything here about changing the directive but I would appreciate any comments that members of the Committee have at this point.

MR. EASTBURN. Paul, could I question Steve? This is Dave Eastburn. Steve, do you have any guess about the aggregates for May?

MR. AXILROD. I have our projections, Dave. They would suggest a growth rate in May of 4-1/2 percent, followed by a growth rate in June of 9.3 percent. That projection assumes interest rates roughly at current levels.

CHAIRMAN VOLCKER. With an error range of plus or minus 10 percent!

MR. EASTBURN. These projections, Steve, were made with a knowledge of what was happening in April?

MR. AXILROD. Yes. They assume really a very modest recovery in the course of May from what we presume will be a slightly higher level in the week of April 30th. If we have a very substantial recovery over the course of May, we could have a rather large [rate of increase] in May. I understand from Peter that the Federal Reserve Bank of New York has a much [higher] projection for May than we now have.

MR. STERNLIGHT. That's true. I'd say red-facedly that we obviously had a stronger April than the Board staff had--far stronger than it turned out. We continue to be higher for May than the Board staff. I think we're projecting about 8 or 9 percent growth.

VICE CHAIRMAN SOLOMON. Are you waiting for reactions?

CHAIRMAN VOLCKER. I'm waiting for substantive reactions, yes.

VICE CHAIRMAN SOLOMON. This is Tony Solomon. Let me say a few words about how we see it here in New York. First of all, I think it's important to say that the market viewed the April [money] numbers as largely reflecting technical problems endemic to April. Market participants don't expect us to change our posture as a result of the April figures and they would be very surprised--and I think disappointed--if we were perceived as overreacting to these one-month developments. The market is really looking for some resistance. And in view of the fact that the April M-1A drop clearly goes beyond anything that can be explained by the economy, we are projecting a substantial comeback for money growth for May and June. So it seems to me that we've got to follow a fairly prudent policy here and not overreact. I would like to suggest that we put a downward limit of 14 or 14-1/2 percent [on the funds rate] for the next two weeks, after which we could meet or confer again. This involves a borrowing assumption of no lower than about $800 million to $1 billion, which I think Steve would feel would be consistent. If we resist going below 14 percent, the fed funds rate would average about 14-1/2 percent next week probably. That's all I have to say at this point, Paul.

CHAIRMAN VOLCKER. Okay. Governor Wallich.

MR. WALLICH. It seems to me that we've become prisoners here of our technique. I don't think from an overall point of view that we want such a sudden degree of easing. [I say that] not because of the dollar, which has importance but is not dominant, but because the impression that would create is that there has been a change in policy. It is not going to help us to say that we haven't changed policy and we're following the same targets as before. People would perceive the big change in interest rates. And I think substantively they would be right; it is a change in policy if we let interest rates drop dramatically. So my suggestion would be to try to hold the line at the [present rate] or a little above it and wait for further developments.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, as you might imagine, I disagree with both Tony and Henry. I think the money supply figures may well be telling us something. The [weakness is] in currency as well as in demand deposits, and it's associated with extraordinarily weak information on the economy. In the last three weeks the initial claims for unemployment insurance have shot up to the level they reached in the spring of 1975. And they show no sign of turning. I just spoke a few minutes ago to a man who operates a very large retail business, and he said that in the month of March he missed his projection of credit outstandings by $20 million. That is, they were $20 million lower than he had [expected]. He had never before missed it by more than $1 million. He said that sales have continued extraordinarily weak in the month of April. The car dealer community is on its ear and so is the automobile industry. There is no building going on except for the completion of single family units that were started earlier, and even there in some cases there has been a stoppage.

So I think there is a fair chance that this money supply [behavior] is telling us that we're now entering into the sharpest phase of recession we've seen any time since World War II. And if that is the case, to maintain interest rates [at their current high levels] and thereby destroy the reserves necessary to support reasonable monetary growth is a grossly wrong policy for the Board or the FOMC to follow. I wouldn't want to panic on this, because it does seem to me that a minus 12 percent rate is just so unbelievable that I can't believe it could continue for any length of time. But I do think, since the Committee has in its [most recently] published directive to the Manager a range for the funds rate that extends down to 13 percent, that we have no business looking at any [lower bound] above 13 percent in terms of limiting the Manager's activity. So I would say that what we ought to do now is to use the full range that's available to us and that we specified only a week ago in the directive--and which has yet to be made public. And we ought to talk in another week to see if it should be reduced further because I think we have to react to what could be a very seriously deteriorating economic situation.

MR. ROOS. This is Larry Roos from St. Louis and I agree totally with Chuck Partee.

MR. BLACK. This is Bob Black and I agree, too, Mr. Chairman. I would be very careful in announcing that if we tried to do it. I'd say there's no change in policy but this is a pursuit of aggregate targets that we set out for ourselves in your recent public statement.

MR. BALLES. This is John Balles, Mr. Chairman. I fully associate myself with Chuck's views, particularly given the fact that this big April decline follows hard on the heels of a March decline. In view of that, we've got to view with considerable skepticism if not alarm, the projections that call for a revival of monetary growth in May and June. I hope it happens. But I think we've got to guard against it not happening at this point. And really, to come down to the 13 percent lower limit we've set for ourselves would not disturb me since 13 percent in absolute terms is still pretty high.

MR. GUFFEY. Mr. Chairman, Roger Guffey. I'd like to associate myself with Governor Wallich and Tony Solomon. It seems to me that we should resist--not overly resist, but resist--[the funds rate] going down too quickly. I would think that a range of 14-1/2 to 15 percent for some short period of time would be very appropriate. I would also agree that maybe a week from now we ought to consult again. I would suggest that the numbers we are looking at in April are just as surprising as the numbers on the other side were in February, and they may not mean a whole lot. I would hate to see us drop the funds rate precipitously strictly to try to get back onto the somewhat artificial path for the first half of 1980. I'd rather take a bit longer. The aggregates are coming in weak but I would not try to get back on path in one month on figures that we're not very certain about.

MR. EASTBURN. Paul, this is Dave Eastburn. I'm having trouble seeing what the risk is of sticking with our path. It seems to me that there's obviously a risk in appearing to panic. On the other hand, there's a risk that we might have to back up. But I think the long-term movement is so definitely in the downward direction that I can't see much risk either way. So I'd stick with the plan that we formulated at the meeting.

MS. TEETERS. Mr. Chairman, it seems to me that if we're wrong, then the market will react and rates will go back up again. That happened to us in November and December and again in February. It seems to me that we should stick to the policy [we established] and [use] the full range and let the interest rate fluctuate. We took that approach when we were going [up on the funds rate]. And if necessary, the market will change [the rate] and push it up if we've made the wrong decision. So I would stick with the 13 percent lower limit.

MR. FORRESTAL. Mr. Chairman, this is Bob Forrestal in Atlanta. We would like to associate ourselves with Governor Wallich and the New York and Kansas City Banks. I recognize that the numbers for April are extraordinarily low and not what we anticipated. On the other hand, I would not be overly concerned about one month's numbers. They could well be technical aberrations. Basically we're on target with what we intended to do last October. I think the greater risk at this point, both domestically and internationally, would be to run the risk of underkill on inflation. Without any reduction of the inflation rate we'd be making a serious mistake if we didn't [show] some resistance at this point to a precipitous decline in interest rates. I think they've fallen enough already and I would like to see the Committee opt for resisting [further declines] at the 14 to 14-1/2 percent level, wait a week to see what happens, and consult again.

MR. MORRIS. Mr. Chairman, this is Frank Morris. I agree with Chuck Partee's analysis. I think the weakness in the aggregates is a reflection of the dramatic and very widespread weakening in the economy. I'm also concerned about the Committee moving back to the management of interest rates. I think Peter has served us well. [This operating technique] has turned the situation around a lot faster than would have occurred if we had been managing interest rates on the up side. For us to turn around and try to manage them on the down side now, I think would be a mistake.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. I agree with Chuck Partee almost completely. I am concerned, though, about the speed with which interest rates fall. If they fall too precipitously and we allow that to happen, I think that runs the risk of giving misleading signals. However, I don't see much difference between 14-1/2 and 13 percent and, therefore, I would certainly favor maintaining our present range. And if at 13 percent there is still substantial downward pressure on the funds rate, then I would want to have another careful look.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. I can agree with Chuck's analysis of the economic situation. I'm not sure that a week may cut much difference in terms of our policy moves at the moment. We may even want to reconsider the 13 percent floor if we get a better reading on unfolding developments. I am concerned about having whipsawed here--allowing further rapid declines in rates and then having them go up very rapidly--in terms of market impact and interpretation and so forth. I could see holding [rates] where they are and taking another reading next week, Mr. Chairman.

CHAIRMAN VOLCKER. I'm a little surprised at all these comments that people agree with Governor Partee's analysis of the business outlook. I don't, if I interpret him correctly. I think the economy may well be declining rapidly now; I'm not sure what that means for the future. I suspect we had a decline in retail sales. The question is whether it will level off and go up again or whether it will continue to decline and I don't see any evidence bearing on the issue. I want to insert [that comment] here.

MR. PARTEE. Our policy will have an effect on that.

MR. ROOS. This is Larry Roos. I'd like to point out one thing. My agreement with Chuck Partee is from the point of view of policy. I'd ask those who feel that we ought to resist the downward movement in the fed funds rate if they don't recognize that the only way we can do that is by pulling reserves out of the System. And that has the effect of exacerbating the downward movement of the economy, which I don't think anybody wants at this stage of the game.

CHAIRMAN VOLCKER. Who has not been heard from here? Governor Schultz.

MR. SCHULTZ. Well, like President Winn, I'm a little concerned about getting whipsawed and I'd like to see us hold the funds rate at 14 percent this week and talk again next week. I love seeing these interest rates come down; I just have some concern about the speed, which has been extraordinarily rapid.

CHAIRMAN VOLCKER. We have a difference of opinion obviously, if we express it in terms of interest rates, and I don't think we should do that directly. Let me just see how this situation lies. I think we ought to talk about the level of borrowings--presumably that's consistent with the way we're going about [conducting policy]--and not about a level of interest rates. What did you say the current level of borrowing is?

MR. AXILROD. This path, Mr. Chairman, has $900 million of borrowing followed by $660 million; that is just what falls out of holding to the nonborrowed [objective] that was set at the time of the Committee meeting. I should hastily add that it makes no adjustment for an initial look [suggesting] that for multiplier reasons we ought to add around $250 million [in reserves]. We did not do that the first week because we have found [in the past] that [the reserve injection] might have to be reversed. So ordinarily [in such cases] we've let that go for a couple of weeks. But should that persist, borrowing would go down another couple hundred million because of the addition. And that makes no allowance for the fact that total reserves are running below path; in the past we have often raised nonborrowed reserves simply for that reason. So what I'm saying is that at the moment, unless there's a big change in deposits, that [$900 million] is kind of the maximum level of borrowings that jumps out of the path. Next week, unless the deposits change, the path could call for a lower level of borrowing.

MS. TEETERS. Steve, with the money supply dropping and a level of borrowings that is relatively high at the present time, where are [the reserves] going? Do we have a massive increase in excess reserves?

MR. AXILROD. No, we're mopping up the excess reserves. What is technically happening is that with required reserves dropping, we're kind of releasing reserves to excess and they are being mopped up. That is what literally is happening. If we supplied all these total reserves, which we couldn't, we would have a massive amount of excess reserves. So we're in effect mopping up the excess reserves that were released by the decline in required reserves.

CHAIRMAN VOLCKER. I don't entirely follow that when the level of borrowings is so high this week, which I think is what Nancy is asking. Why is the level of borrowing so high?

MR. AXILROD. Well, borrowings ought to drop off to almost nothing today and tomorrow. Our estimate is that they might drop off to $600 or $700 million. If we literally followed the nonborrowed path, they would drop off to very close to zero to achieve this $900 million [average]. But banks did borrow quite a lot early in the week--more than we think is needed given the required reserves and the amount we were planning to provide by nonborrowed reserves. So at the end of this week, the funds rate would drop and the level of borrowing would drop.

MS. TEETERS. I guess what I'm really saying is that the level of borrowing seems inconsistent with the money supply.

MR. AXILROD. Well, do you mean the $900 million we're planning on or--

MS. TEETERS. No, I mean the actual.

MR. AXILROD. In terms of the actual of $2.3 billion, you have to take out the $700 million that is First Pennsy. So that puts it down to $1.5 or $1.6 billion. Whether that is consistent or inconsistent with the money supply would depend in part on banks' response to that level of borrowing. We believe that it is high [in relation to] this money supply, but we have been wrong before on banks' attitudes toward borrowing. And it may be that they're quite happy and are willing to borrow and are going to go on and expand despite that. Our judgment is that the level of borrowing would have to be lower to promote a very rapid rise in the money supply.

CHAIRMAN VOLCKER. Your current path is based upon $900 million of borrowing?

MR. AXILROD. Yes. That is simply because of the weakness in required reserves relative to what we had planned at the time of the Committee meeting. It makes no allowance for multipler changes or any effort to compensate for the reduction in total reserves relative to the path.

CHAIRMAN VOLCKER. Well, I'm thinking that the obvious thing may be just to maintain--in the short run anyway--that $900 million, which is what fell out anyway. That is $600 million lower than we were talking about a week ago. And then let's see what the next figures bring or whatever.

MR. PARTEE. I do think, Paul, that we'd have to follow practice and look at the multiplier, if it holds up to be a shift. But it probably would be another week before we'd have that information. So for the week $900 million is all right.

VICE CHAIRMAN SOLOMON. I think it makes a lot of sense, Paul, to work on that borrowing assumption of $900 million.

CHAIRMAN VOLCKER. I'm talking about a short time period here. We'll get a new money supply figure shortly and we will get some other evidence. But I think this is fully consistent with what we said. We're going through the checkpoint. In a sense we relaxed the $1-1/2 billion that we started with because it falls out. And we're saying let it fall out. I don't see any need for any specific decision other than that we're saying we should stay more or less on the path. We're not leaning over backwards to push it up, along the line of reasoning that Steve suggested could be used, but we're not deliberately pulling back either.

VICE CHAIRMAN SOLOMON. But isn't it possible, even with a borrowing assumption of $900 million, that we will still have a very precipitous decline in the fed funds rate due to uncontrollable factors? The question that I think we are still left with, which we should face up to, is do we want to show some resistance in that area.

CHAIRMAN VOLCKER. Well, the resistance still comes at 13 percent, of course, in a firm way. I guess what we're saying is that we don't want to manage the rate in this area. But from some points of view--it depends upon how you want to argue--the $900 million of borrowing could be considered to be too high if you really wanted to push the money supply with maximum force. In that sense, we're taking account of it.

MR. AXILROD. Mr. Chairman, with that level of borrowing, the 13 percent discount rate I believe is a very effective floor for the funds rate. And so with the--

CHAIRMAN VOLCKER. By "floor" you mean [the funds rate] is not likely to go to 13 percent.

MR. AXILROD. That's right.

MR. STERNLIGHT. Well, not below but it could be darn close to it.

MR. AXILROD. You're talking about something like $400 or $500 million borrowing above minimal levels. So we would expect some spread of the funds rate above the discount rate--[a funds rate] in the 13-1/2 to 14-1/2 percent area.

CHAIRMAN VOLCKER. Without allowing anything for the surcharge.

MR. AXILROD. Yes, without allowing any resistance.

CHAIRMAN VOLCKER. Well, it's a fine judgment. I don't think there is any obvious answer. It will be wrong if the money supply very promptly goes up again in some sense. It will be wrong in the other direction, I suppose, if the economy really is weak and the money supply turns out to be as weak as some of the more pessimistic views. The funds rate seems to me a little high relative to other market rates. Is that a fair conclusion? I don't think a decline in the funds rate in itself implies much change in other rates.

MR. STERNLIGHT. Well, looking at day-to-day rates, Mr. Chairman, the funds rate has come down most recently to about 14 percent. I would have said a few days ago that funds had lagged a little against some other market rates but I think it has had a fairly substantial decline now.

CHAIRMAN VOLCKER. It depends upon which rates one looks at, I suppose. It seems to me a little high relative to the bill rate, and some government rates. It may be not high relative to the CD rate and--

MR. STERNLIGHT. I suppose that's right, but at 14 percent it would be some 3-1/2 percentage points under last week's average. Mr. Chairman, would I be right in inferring from the approach that you suggested that there is no great reluctance to see the funds rate move somewhat below 14 percent or down toward the 13 percent level?

CHAIRMAN VOLCKER. I think there's a reluctance by more than half of the members of the Committee to see that happen. But we're saying we're not guiding it that directly.

MR. RICE. We're not going to panic.

MR. STERNLIGHT. If it happened in the pursuit of our paths--

CHAIRMAN VOLCKER. If it happened in the pursuit of a conservative path, we're saying it's going to happen. But I assure you, from my listening to the comments anyway, that more than half the members of the Committee are not going to be joyous about it and would be much happier if it stayed someplace around 14 percent. It's roughly a 50/50 split. So I think we're reflecting that by not moving the borrowing as rapidly as it could be moved.

MR. PARTEE. Let's see how the figures develop.

CHAIRMAN VOLCKER. Yes. Okay, as I said, I don't think this requires any vote. We're just confirming the [existing] directive. Thank you.

END OF SESSION